APPENDIX A

No. 54,607

IN THE SUPREME COURT OF THE STATE OF OKLAHOMA

SOONER FEDERAL SAVINGS & LOAN ASSOCIATION, KAY COUNTY FEDERAL SAVINGS & LOAN ASSOCIATION, and FIRST FEDERAL SAVINGS & LOAN ASSOCIATION OF LAWTON
Appellants

v.

OKLAHOMA TAX COMMISSION, and THE STATE OF OKLAHOMA
Appellee

APPEAL FROM THE OKLAHOMA TAX COMMISSION
ORDER NO. 79-12-04-06

SOONER FEDERAL SAVINGS & LOAN ASSOCIATION, KAY COUNTY FEDERAL SAVINGS & LOAN ASSOCIATION, AND FIRST FEDERAL SAVINGS & LOAN ASSOCIATION OF LAWTON, APPEAL FROM AN ORDER OF THE OKLAHOMA TAX COMMISSION DENYING THEIR CLAIMS FOR REFUNDS OF STATE INCOME TAXES PAID.

AFFIRMED

E. John Eagleton,
James A. Hogue, Sr.
Houston and Klein, Inc.
Tulsa, Oklahoma, *For Appellants,*

Donna E. Cox,
Oklahoma City, Oklahoma, *For Appellee.*

BARNES, V.C.J.:

This case is before the Court on appeal by Sooner Federal Savings & Loan Association, Kay County Savings & Loan Association and First Federal Savings & Loan Association of Lawton, from Order No. 79-12-04-06, issued December 4, 1979 by the Oklahoma Tax Commission, denying claims for refund of state income tax paid for taxable years 1972, 1973 and 1974. In their claims before the Commission, appellants sought refunds of state corporate income tax liabiliity calculated, reported and paid on dividends distributed to appellants on stock issued by a Federal Home Loan Bank.

All the facts were presented to the Commission upon stipulation and are as follows:

1. Appellants are federally charted savings and loan associations.

2. Appellants are required to own stock in Federal Home Loan Bank as a condition of membership in the federal home loan bank system.

3. Appellants received dividends on Federal Home Loan Bank stock owned by them in the years 1972, 1973 and 1974 and subsequent income tax years.

4. Appellants voluntarily reported and paid Oklahoma corporation income taxes on said dividends under Oklahoma Income Tax Code, Title 68 O.S. 1981 §2351 et seq., in the total amount of $13,802.12 for the years 1972, 1973, and 1974, which taxes are claimed by the state solely by virtue of the dividends received by appellants on Federal Home Loan Bank stocks owned by them.

5. Federal Home Loan Bank was organized and exists by virtue of the Federal Home Loan Bank Act, 12 U.S.C. §1421 et seq.

6. Congressional history of 12 U.S.C. §1433 reveals said section was enacted to provide funds more cheaply to home buyers.

7. Section 6(c) of the Federal Home Loan Bank Act provides a formula for the amount of stock each member association must own and maintain as long as it retains Bank membership, which amount is directly related to the member's advances, i.e., as the amount of stock paid in by a member association increases, its maximum amount of aggregate outstanding stock increases.

The issue before the Court is whether dividends disbursed by Federal Home Loan Bank, pursuant to 12 U.S.C. §1421 et seq., to its stockholders, appellants, are subject to taxation under the Oklahoma Income Tax Code as income of said appellants.

Order No. 79-12-04-06, issued by the Commission after full hearing, included findings that the dividends claimed to be exempt from state tax is income to appellants and subject to nondiscriminatory state income tax as authorized by 12 U.S.C. §1464.

Appellants advance two main contentions. The first is that §1433 of 12 U.S.C. exempts from state taxation dividends on stock issued by Federal Home Loan Banks to its members. The pertinent part of said section is as follows:

> "Any and all notes, debentures, bonds and other such obligations issued by any bank, and consolidated Federal Home Loan Bank bonds and debentures, shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any territory, dependency, or possession thereof, or by any state, county, municipality, or local taxing authority. The bank, including its franchise, its capital, reserve,

and surpluses, its advances, and its income, shall be exempt from all taxation now or hereafter imposed by the United States, by any territory, dependency, or possession thereof, or by any state, county, municipality, or local taxing authority; . . . "

Appellants further urge that "exemption" clauses "similar" to §1433, *supra,* are found in the Federal Reserve Act, Federal Farm Loan Act, and Federal Home Loan Bank Act, pertaining to Federal Reserve Banks, Federal Land Banks and Federal Home Loan Banks, respectively. Appellants also cite a portion of 12 U.S.C. §531 as showing intent of Congress in §1433, *supra,* to exempt their stock from state taxation, and underline that part relied on as follows:

"Attention should also be given to the provisions exempting Federal Reserve Banks, *and the stock held therein by member banks from all classes of taxation.*"

Appellants state therefore since they are members of the Federal Home Loan Bank, and hold stock therein, dividends paid on that stock is tax exempt.

Appellant's second contention is that Congress has not expressly or impliedly declared that its instrumentalities (Federal Home Loan Banks) are subject to state taxation as pertaining to the specifically mentioned items in §1433, *supra.*

Appellee, Oklahoma Tax Commission, counters that 12 U.S.C. §1464(h) controls in this case and not §1433, *supra.*

12 U.S.C. §1464 created federally charted savings and loan associations and mandated automatic membership of the associations in a Federal Home Loan Bank.

12 U.S.C. §1464(h) is as follows:

"No state, county, municipal, or local taxing authority shall impose any tax on such associations or their franchise,

capital, reserves, loans, or income greater than that imposed by such authority on other similar local mutual or cooperative thrift and home financing institutions."

Appellee also cites 12 U.S.C. §1464(k):

"All stock of any federal home loan bank shall share in dividend distributions without preference."

And, 12 U.S.C. §1436:

" . . . No dividends shall be paid except out of net earnings remaining after all reserves and charge-offs required under this chapter have been provided for . . . "

In referring to 12 U.S.C. §1464(h), §1426(k) and §1436, *supra,* appellee contends these enactments show Congressional intent that federally chartered savings and loan associations should enjoy dividend income from their Federal Home Loan Bank stock, paid without preference out of the net earnings of the Federal Home Loan Bank, and that the savings and loan associations should pay a state tax imposed in a nondiscriminatory manner on their respective incomes; that Congress did not declare federally chartered savings and loan associations to be federal instrumentalities, nor grant them an exemption on their dividend income from state taxation; that Congress, by enacting §1433, *supra,* expressly protects its purely governmental entities from state taxation and specifically sets forth Federal Home Loan Banks as one such entity, that in enacting §1433, *supra,* Congress could have just as expressly included the income of federally chartered savings and loan associations in the tax exemption but it did not.

We agree with appellee that its order of December 4, 1979 taxing appellants' dividend income from their stock in Federal Home Loan Bank is authorized by §1464(h), *supra,* and is proper in its application.

Appellants do not complain that the Oklahoma tax imposed is discriminatory or that their income, other than their dividends from Federal Home Loan Bank stock, is not subject to state taxing powers as are other similar financial institutions in Oklahoma, but only that this particular income is exempt under §1433, *supra.*

However, §1433, *supra,* as heretofore stated, does not set forth, or even imply, that federally chartered savings and loan associations were to be included in the exemption granted to Federal Home Loan Banks, but does specifically name, along with *"any bank,"* Federal Home Loan Banks. The section also states, the *bank,* (referring to Federal Home Loan Bank), including *its* franchise, *its* capital, reserves and surpluses, *its* advances, and *its* income, shall be exempt . . . " (emphasis added)

Thus §1433, *supra,* by its very language, intends that the Federal Home Loan Bank be exempt from state taxation and in no way refers to federal savings and loan associations.

Appellants second contention is that the tax imposed by appellee on their dividend income is a tax on a federal instrumentality and is therefore contrary to constitutional and statutory provisions.

The general rule is that the states are without power to tax a federal instrumentality without consent of Congress. *McCullough v. Maryland,* 17 U.S. 316 (Md. 1918); *Colorado National Bank v. Belford,* 310 U.S. 1 (Colo. 1940); *Federal Land Bank v. Bismark,* 314 U.S. 995 (1941); *Federal Land Bank v. Board of County Commissioners,* 368 U.S. 146 (1961).

However, federally chartered savings and loan associations are not federal instrumentalities within the meaning of the statutory provisions. They are not national banks, federal reserve banks, federal land banks, or federal home loan banks,

to which immunity from state taxation is made clear and we find no authority to support appellants' contention that the tax immunity granted to these federal instrumentalities should extend to the dividend income of appellants from their stock in Federal Home Loan Bank.

A review of case law involving §1464(h) supports nondiscriminatory state taxation of *all* the income of federal savings and loan associations. (emphasis added).

In *First Federal Savings and Loan Association of Altadena v. Johnson, State Treasurer, et al,* 122 P.2d 84 (Cal. 1942), First Federal Savings sought a refund of franchise taxes paid on that portion of its net income derived from funds invested by the federal government. First Federal Savings, just as appellants here, contended the tax was illegally levied because its income was exempt from all state taxes since it was an agency of the United States, and Congress had not affirmatively authorized such income to be taxed because it was income derived from the investment of funds furnished by the government.

As to congressional intent subjecting the income of federal savings and loan associations to state taxes, the California court stated at p. 86 of its opinion:

> "It is acknowledged that Congress may lawfully authorize the states to levy and collect taxes on certain property and assets or income derived from governmental agencies doing business in such states by appropriate legislation therefor. From time to time, ever since 1864, Congress has specifically authorized the states to levy and collect taxes on specified classes of property and income of particular governmental agencies."

In referring to §1464, *supra,* amended by Congress in 1934, authorizing the creation of federal savings and loan associations, the California court continued at p. 86:

"It is not stated that such associations shall become instrumentalities of the United States, . . . Nor is it stated in §1464, *supra*, . . . that the corporations property and assets are exempt from taxation. On the contrary, it is clearly inferred by the provisions of subdivision (h) of §1464, that states are authorized to tax the income derived from such associations."

Continuing at p. 86 the California court said:

"Although the language of subdivision (h) of §1464 with respect to state taxation of federal agencies is negative in form, its meaning is clear and unambiguous."

The California court concluded at p. 88, in referring to the taxability of such income:

"No such limitation is placed upon the taxing power of the states by the provisions of subdivision (h) of §1464. It authorizes the state to tax all incomes of such associations. That provision contemplates the taxing of all such associations of their franchises, capital, reserves, surplus, loans or income to an extent not 'greater than that imposed by such authority on other similar local mutual or cooperative thrift and home financing institutions.' This absence of a limitation leaves the clear inference that the entire income is taxable and that the portion which is derived from loans of funds invested by the federal government is not exempt. If Congress had intended to exempt the income derived from that source it would have so stated."

We find the language in First Federal, supra, very persuasive in its construction of §1464(h), *supra*, in that dividends from Federal Home Loan Bank stock received by member federal savings and loan associations is income subject to state taxation. See also *United States v. New Mexico*, March 24, 1982, 50 LW 4329 (1982).

In *First Federal Savings and Loan Association of Boston*,

et al v. State Tax Commission, et al, 98 S.C. 2333 (Mass. 1978 437 U.S. 255, the United States Supreme Court went directly to the issue of the non-discriminatory taxation aspect of §1464(h), *supra.* First Federal Savings sought a declaratory judgment concerning the power of the State of Massachusetts to impose a tax on federal savings and loan associations. The *Supreme Judicial Court of Massachusetts,* 372 Mass. 478, 363 N.E. 2d 474, upheld the challenged portion of the tax and the savings and loan association appealed. The U.S. Supreme Court treated said section as congressional consent to state taxation of the income of federal savings and loan associations. The Court stated, "It (Section 1464(h)) is one of several laws passed by Congress to protect federally chartered financial institutions from unequal and unfriendly competition caused by state laws favoring state chartered institutions. On its face, however, the Massachusetts tax scheme is not unfriendly or discriminatory."

In *First Federal Savings and Loan Association v. Loomus,* 97 F.2d 831 (Wis. 1938), the 7th Circuit Court of Appeals stated, "12 U.S.C.A. §1464(h) . . . permits state taxation only to the extent that similar state institutions are taxed."

In *Winchester, et al v. Porterfield, Tax Commissioner,* 271 N.E.2d 786 (Ohio 1971), the Ohio court interpreted §1464(h) " . . . which prohibits any state tax which discriminates against a federal association, thus impliedly granting the state power to tax upon the basis of similar treatment of similar local or state institutions."

In reaching our conclusion, we further hold that when a Federal Home Loan Bank distributes dividends to its member federal savings and loan associations, these dividends become income to said members, the disposition of which the Federal Home Loan Bank has no further control. Such becomes in-

come, just as interest on savings and loan association loans to the public, becomes income. The ownership of that income (dividends) has shifted to federal home loan associations, appellants, and these dividends supply income and are a part of the profits of the federal savings and loan associations, and are subject to state taxation under §1464(h), *supra.*

We therefore affirm Order No. 79-12-04-06 of the Oklahoma Tax Commission.

ALL JUSTICES CONCUR.

APPENDIX B

No. P-79-014

BEFORE THE OKLAHOMA TAX COMMISSION THE STATE OF OKLAHOMA

IN THE MATTER OF THE PROTEST OF SOONER FEDERAL SAVINGS & LOAN ASSOCIATION, KAY COUNTY FEDERAL SAVINGS & LOAN ASSOCIATION AND FIRST FEDERAL SAVINGS & LOAN ASSOCIATION OF LAWTON TO THE DENIAL OF CLAIMS FOR REFUNDS OF INCOME TAXES

ORDER NO. 79-12-04-06

This matter came on before the Oklahoma Tax Commission on the 8th day of November, 1979, upon the protest of Sooner Federal Savings & Loan Association, Kay County Federal Savings & Loan Association and First Federal Savings & Loan Assocation of Lawton to the denials of claims for refund of income taxes issued on May 25, 1976, May 21, 1976, and May 26, 1976, respectively, by the Income Tax Division of the Oklahoma Tax Commission and upon the Findings and Recommendations of the hearing officer of the Oklahoma Tax Commission issued on October 25, 1979.

The Commission proceeded to examine the files and records in this matter, and being fully advised in the premises, finds:

1. This matter came on for hearing before the duly appointed hearing officer of the Oklahoma Tax Commission pursuant to §228 of Title 68 of the Oklahoma Statutes.

2. On October 25, 1979, said hearing officer issued Findings and Recommendations in this matter upon consideration of the evidence, oral argument of counselors and hearing briefs presented herein.

3. Said Findings and Recommendations were mailed to counselors for protestants on October 26, 1979.

4. Said findings and recommendations should be adopted and upheld by the Commission as set out hereinafter.

5. Sooner Federal Savings and Loan Association, Kay County Federal Savings and Loan Association and First Federal Savings and Loan Association of Lawton, taxpayers and protestants herein, each voluntarily reported and paid for the 1972, 1973 and 1974 tax years, Oklahoma income taxes on dividends distributed to protestants on stock issued by a Federal Home Loan Bank. And, subsequent thereto, each protestant timely filed claims for refunds for income tax years 1972, 1973 and 1974 for taxes paid on said dividends distributed to said protestants by the Federal Home Loan Bank. And, said claims for refunds were as follows: Sooner Federal Savings and Loan Association submitted claims for refund in the total amount of $12,999.74; Kay County Federal Savings and Loan Association submitted claims for refund in the total amount of $483.10; and, First Federal Savings and Loan Association of Lawton submitted claims for refund in the total amount of $319.28, as set out in protestants' tax returns, Exhibit 1 through 8, both inclusive, admitted at the hearing of this matter, plus statutory interest accumulating.

6. Each of said claims of protestants for refund of income taxes paid was denied by the Director of the Income Tax Division of the Oklahoma Tax Commission as set out in Exhibits 9, 10, and 11, admitted at the hearing of this matter.

7. Each of said denials of said claims for refund of income taxes paid were timely protested in accordance with §2373 and §228 of Title 68 of the Oklahoma Statutes as set out in Exhibit 12, admitted at the hearing in this matter.

8. Protestants are federally chartered savings and loan associations.

9. Protestants are required to hold stock in the Federal Home Loan Bank system.

10. Protestants received dividends on the Federal Home Loan Bank's Stock held by them in the years 1972, 1973, and 1974, and subsequent tax years.

11. The Federal Home Loan Bank in which claimants hold stock is organized and exists by virtue of an act of Congress, the Federal Home Loan Bank Act, 12 U.S.C., Section 1420 et seq.

12. The Congressional history of 12 U.S.C. §§1433 reveals that that section was enacted to provide funds more cheaply to home buyers.

13. Section 6(c) of the Federal Home Loan Bank provides a formula for the amount of stock each member association must hold and maintain as long as it retains bank membership, which amount is directly related to the members' advances, i.e. as the amount of stock paid in by member associations increases, its maximum amount of aggregate outstanding stock increases.

14. Pursuant to the language of 12 U.S.C. Sections 1426(k) and 1436, the distributions received by protestants, by virtue of stock issued by Federal Home Loan Bank to the respective protestants, which protestants contend are exempt from state income taxation and claim refunds for Oklahoma income tax paid thereon, are dividends paid from the net earnings of the issuing Federal Home Loan Bank.

15. Dividends distributed by a Federal Home Loan Bank to its stock holding members, protestants herein, constitute income to the member banks.

16. 12 U.S.C. §1433 prohibits taxation of income of Federal Home Loan Banks and does not prohibit taxation of income of federally chartered savings and loan associations.

17. 12 U.S.C. Section 1464(h) permits states to impose state taxation upon the income of federally chartered savings and loan associations which is not greater than the same state taxation imposed by such authority on other similar local mutual or cooperative thrift and home financing institutions.

18. Protestants have not contended or offered any evidence that the Oklahoma income tax paid by them and sought to be refunded herein is in any manner a discriminatory tax.

19. Section 2358 A.2. of Title 68 of the Oklahoma Statutes, providing a deduction from Oklahoma taxable income or adjusted gross income of any income that the state is prohibited from taxing under the Federal or State constitutions or other Federal or state laws, is not applicable to the income involved herein as same is subjected to state taxation by 12 U.S.C. 1464(h). And,

20. The recommendation of the hearing officer that the claims for refund of protestants should be denied as the dividends distributed upon stock issued by Federal Home Loan Banks to protestants are subject to Oklahoma income tax should be upheld.

THEREFORE, IT IS HEREBY ORDERED by the Oklahoma Tax Commission that the claims for refunds of Sooner Federal Savings and Loan Association, Kay County Federal Savings and Loan Association and First Federal Savings and Loan Association of Lawton for income taxes paid for tax years

1972, 1973, and 1974, on dividends distributed on stock issued by Federal Home Loan Banks, shall be, and the same are hereby, denied.

ATTEST

MARY JANE SINCLAIR
Assistant Secretary

APPROVED:

DENNIS G. BALCH
Director
Income Tax Division

APPROVED AS TO FORM:

MARJORIE PATMAN
General Counsel

DONNA E. COX
Attorney

OKLAHOMA TAX COMMISSION

JAMES E. WALKER
Chairman

JOHN L. GARRETT,
Vice Chairman

J. L. MERRILL,
Secretary-Member

APPENDIX C

No. 54,607

IN THE SUPREME COURT OF THE STATE OF OKLAHOMA

SOONER FEDERAL SAVINGS & LOAN ASSOCIATION, KAY COUNTY FEDERAL SAVINGS & LOAN ASSOCIATION, and FIRST FEDERAL SAVINGS & LOAN ASSOCIATION OF LAWTON
Appellants

vs.

OKLAHOMA TAX COMMISSION, and THE STATE OF OKLAHOMA
Appellees

NOTICE OF APPEAL TO THE
SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Sooner Federal Savings and Loan Association, Kay County Federal Savings and Loan Association, and First Federal Savings and Loan Association of Lawton, the Appellants above-named, hereby appeal to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of Oklahoma affirming Order No. 79-12-04-06 of the Oklahoma Tax Commission, entered herein on October 5, 1982.

This appeal is taken pursuant to 28 U.S.C. §1257(2).

Respectfully submitted,
HOUSTON AND KLEIN, INC.

BY: E. JOHN EAGLETON
THOMAS G. POTTS
JAMES A. HOGUE, SR.
Attorneys for Appellants
3200 University Tower
1722 South Carson
P.O. Box 2967
Tulsa, Oklahoma 74101
(918) 583-2131

CERTIFICATE OF MAILING

I, Thomas G. Potts, do hereby certify that a true and correct copy of the above and foregoing Notice of Appeal was forwarded by certified mail this 13th day of October, 1982, with sufficient postage fully prepaid to:

Ms. Donna E. Cox
Oklahoma Tax Commission
2502 Lincoln Blvd.
Oklahoma City, Oklahoma 73204

THOMAS G. POTTS

APPENDIX D

No. 54,607

IN THE SUPREME COURT OF THE STATE OF OKLAHOMA

SOONER FEDERAL SAVINGS & LOAN ASSOCIATION, KAY COUNTY FEDERAL SAVINGS & LOAN ASSOCIATION, and FIRST FEDERAL SAVINGS & LOAN ASSOCIATION OF LAWTON
Appellants

vs.

OKLAHOMA TAX COMMISSION, and THE STATE OF OKLAHOMA
Appellees

MOTION TO STAY MANDATE

COMES NOW, the Appellants, Sooner Federal Savings and Loan Association, Kay County Federal Savings and Loan Association and First Federal Savings and Loan Association of Lawton, and move this Court to stay the mandate of judgment in this matter pending Appellants' appeal to the United States Supreme Court.

Respectfully submitted,
HOUSTON AND KLEIN, INC.

BY: E. JOHN EAGLETON
THOMAS G. POTTS
JAMES A. HOGUE, SR.
3200 University Tower
1722 South Carson
P.O. Box 2967
Tulsa, Oklahoma 74101
(918) 583-2131
Attorneys for Appellants

CERTIFICATE OF MAILING

I, Thomas G. Potts, do hereby certify that a true and correct copy of the above and foregoing Motion to Stay Mandate was forwarded by certified mail this 13th day of October 1982, with sufficient postage fully prepaid to:

Ms. Donna E. Cox
Oklahoma Tax Commission
2502 Lincoln Blvd.
Oklahoma City, Oklahoma 73204

THOMAS G. POTTS

APPENDIX E

No. 54,607

IN THE SUPREME COURT OF THE STATE OF OKLAHOMA

SOONER FEDERAL SAVINGS & LOAN ASSOCIATION, KAY COUNTY FEDERAL SAVINGS & LOAN ASSOCIATION, and FIRST FEDERAL SAVINGS & LOAN ASSOCIATION OF LAWTON
Appellants

vs.

OKLAHOMA TAX COMMISSION, and THE STATE OF OKLAHOMA
Appellees

ORDER

The Court notes appellants' notice of appeal to the Supreme Court of the United States, filed October 14, 1982. The appellants' motion to stay mandate is therefore granted, and issuance of mandate from this Court is stayed until December 6, 1982. If appellants have perfected an appeal to the Supreme Court of the United States on or before such date, then issuance of mandate shall be further stayed until final disposition of the appeal by that Court, or until further order of this Court.

DONE BY ORDER OF THE SUPREME COURT IN CONFERENCE THIS 25th DAY OF OCTOBER, 1982.

Chief Justice

APPENDIX F

Federal Home Loan Bank Board
October 29, 1975

Mr. Harry C. Erwin, CPA
Managing Partner
Russell Brown & Company
900 Boyle Building
Little Rock, Arkansas 72201

FEB. 12, 1979
Legal Opinion

Re: American S&LA
Springdale, Arkansas
FHLBB No. 6416

Dear Mr. Erwin:

Mr. W. O. Churchill, Jr., Office of the Supervisory Agent, Federal Home Loan Bank Board, Little Rock, Arkansas, has advised us of your request for an opinion as to whether the State of Arkansas may include in the taxable income of the American Savings and Loan Association, Springdale, Arkansas, dividends received on the capital stock it holds in the Federal Home Loan Bank of Little Rock.

For the reasons set forth below, it is our opinion that §13 of the Federal Home Loan Bank Act (12 U.S.C. 1433, hereinafter "§13")[1] and that such taxation constitutes a prohibited taxation of a federal instrumentality without the consent of Congress.

---

[1] Section 13 provides in part as follows:

> Any and all notes, debentures, bonds, and other such obligations issued by any bank, and consolidated Federal Home Loan Bank bonds and debentures, shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority. *The bank, including its franchise, its capital, reserves, and surplus, its advances, and its income shall be exempt from all taxation now or hereafter imposed by the*

The Legal Division, Arkansas Department of Finance and Administration, apparently has concluded that such dividends are not exempt from State taxation since §13 does not specifically refer to dividends on Bank stock and such stock is not an "obligation of the United States" as that term is used in the exemption provisions of 31 U.S.C. 742.[2] Although we agree of course, with the latter contention, we do not agree that dividends on Bank stock are taxable by the State of Arkansas.

A Federal Home Loan Bank, such as the Federal Home Loan Bank of Little Rock, is organized and exists under an Act of Congress, the Federal Home Loan Bank Act (12 U.S.C. 1421 *et seq.*), and is clearly a federal instrumentality. Each such Bank is subject to regulation and supervision by the Federal Home Loan Bank Board, which is an independent agency in the executive branch of the Federal Government (12 U.S.C. 1437(b)). Congress created Federal Home Loan Banks to furnish reserve banking facilities for savings and loan associations and similar banking institutions which loan mortgage money to home buyers. The Federal Home Loan Bank System, so created, is one element of a tripartite national credit system of federal instrumentalities made up of the Federal Reserve System, the Federal Farm Loan System, and the Federal Home Loan Bank

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Footnote 1 continued:

United States, by any Territory, dependency, or possession thereof, *or by any State, county, municipality, or local taxing authority;* except that in any real property of the bank shall be subject to State, Territorial, county, municipal, or local taxation to the same extent according to its value as other real property is taxed. [Emphasis added.]

[2] 31 U.S.C. 742, as amended, provides in relevant part that:

Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. . . . "

System, which respectively fulfill the function of supplying credit to the business community, farmers, and homeowners.

In the only case to date to consider the status of a Federal Home Loan Bank, the United States Court of Appeals for the Ninth Circuit determined that such a Bank is a "federal instrumentality organized to carry out public policy and its functions are wholly governmental". *Fahey v. O'Melveny & Myers,* 200 F.2d 420, 446-447 (1952), *cert. denied,* 345 U.S. 952. The *O'Melveny* court also observed that cases dealing with Federal Reserve Banks and Federal Land Banks are pertinent to inquiries concerning Federal Home Loan Banks because of the similarity in their plans and purpose 200 F.2d at 445.

The Supreme Court repeatedly has held that States may not tax federal instrumentalities without the specific consent of Congress. *E.g., McCulloch v. Maryland* 17 U.S. (4 Wheat) 316 (1819); *Colorado National Bank v. Bedford,* 310 U.S. 41 (1940); *Federal Land Bank v. Bismarck,* 314 U.S. 95 (1941); *Federal Land Bank v. Board of County Commissioners,* 368 U.S. 146, 149 (1961). With particular relevance to this case, a long line of decisions by the United States Supreme Court has "firmly established the proposition that the States are without power, unless authorized by Congress, to tax federally created, or, as they are presently called, national, banks". First Agricultural National Bank of Berkshire County v. State Tax Commission, 392 U.S. 339, 340-341 (1968). While the applicability of the foregoing doctrine to national banks at the level of the First National Bank of Little Rock (or any similar commercial national bank) may be subject to question, it is settled law with respect to national banks such as Federal Reserve Banks, Federal Land Banks, and Federal Home Loan Banks (*id.* at 362), even though the obligations of such banks may not be, in a strict legal sense, obligations of the United States. Thus, the Supreme Court, in

the application of this doctrine to Federal Land Banks, stated in *Federal Land Bank v. Bismarck, supra,* 314 U.S. at 102-103:

> The argument that the lending functions of the federal land banks are proprietary rather than governmental misconceives the nature of the federal government with respect to every function which it performs. The federal government is one of delegated powers, and from that it necessarily follows that any constitutional exercise of its delegated powers is governmental. It also follows that, when Congress constitutionally creates a corporation through which the federal government lawfully acts, the activities of such corporation are governmental.
>
> The federal land banks are constitutionally created, and respondents do not urge otherwise. Through the land banks the federal government makes possible the extension of credit on liberal terms to farm borrowers. As part of their general lending functions, the land banks are authorized to foreclose their mortgages and to purchase the real estate at the resulting sale. They are instrumentalities of the federal government, engaged in the performance of an important governmental function. The national farm loan associations, the local co-operative organizations of borrowers through which the land banks make loans to individuals, are also federal instrumentalities.
>
> Congress has the power to protect the instrumentalities which it has constitutionally created. This conclusion follows naturally from the express grant of power to Congress 'to make all laws which shall be necessary and proper for carrying into execution all powers vested by the Constitution in the Government of the United States.' We have held on three occasions that Congress has authority to prescribe tax immunity for activities connected with, or in furtherance of, the lending functions of federal credit agencies [citations and footnotes omitted].
>
> It is significant that Congress has not only failed to

authorize State taxation of the income of the three elements of the national credit system (the Federal Reserve Banks, the Federal Land Banks, and the Federal Home Loan Banks), but has statutorily exempted such income from all forms of State taxation. Federal Reserve Act §7, 12 U.S.C. 531 (hereinafter "§13"); Federal Farm Loan Act §26, 12 U.S.C. 931 (hereinafter "§26"); Federal Home Loan Bank ACt §13, 12 U.S.C. 1433. Each of the three exemptions contains substantially the same language.

Section 7 provides as follows:

> "Federal reserve banks, including the capital stock and surplus therein and the income derived therefrom, shall be exempt from Federal, State and local taxation, except taxes upon real estate". Section 7 was the first "standard exemption" provision (*Federal Land Bank v Bismarck, supra,* 314 U.S. at 101, ftn. 7), and apparently served as a prototype for §§13 and 26. The broad scope that Congress intended to be given to this exemption may be discerned from the following extract from its legislative history:
>
> *Attention should also be given to the provisions exempting Federal reserve banks and the stock held therein by member banks from all classes of taxation,* save such taxation as may be imposed upon the real estate held by these banks. In view of the increasing burden of taxation and of the Federal income-tax law, which now furnishes an additional draft upon net earnings. *this exemption is likely to prove of material importance, since it amounts to an exemption of a corresponding proportion of the funds of member banks from the payment of tax to which they would otherwise be subjected.* [Emhasis added.] H. Rept. No. 69, 63d *Cong.,* 1st *Sess.,* p.39

The Federal Reserve Board, of course also takes the position that dividends received by member banks on the stock of Federal Reserve Banks are exempt from State taxation, and we

understand that the Arkansas authorities recognize this position.

Section 26, which exempts Federal Land Banks from State and local taxation, reads in pertinent part as follows:

> [E]very Federal land bank . . . including the capital and reserve or surplus therein and the income derived therefrom, shall be exempt from Federal, State, municipal, and local taxation, except taxes upon real estate. . . .

The broad scope of this exemption is reflected in the Supreme Court's opinion in *Federal Land Bank v. Bismarck, supra,* which involved an attempt by the State of North Dakota to impose a sales tax upon certain building materials purchased by the Federal Land Bank of St. Paul for repair and improvement of real estate acquired through foreclosure. In deciding that the provisions of §26 were broad enough to invalidate this tax, despite the absence of a specific referral to a sales tax in §26, the Court stated in part as follows (314 U.S. at 99-100):

> The unqualified term "taxation" used in §26 clearly encompasses within its scope a sales tax such as the instant one, and this conclusion is confirmed by the structure of the section. In reaching an opposite conclusion the court below ignored the plain language, "That every Federal land bank . . . shall be exempt from Federal, State, municipal, and local taxation," and seized upon the phrase, "including the capital and reserve or surplus therein and the income derived therefrom," as delimiting the scope of the exemption. The protection of §26 cannot thus be frittered away. We recently had occasion, under other circumstances, to point out that the term "including" is not one of all-embracing definition, but connotes simply an illustrative application of the general principle. If the broad exemption accorded to "every Federal land bank" were limited to the specific illustrations mentioned in the participial phrase introduced by "including," there would have been no

necessity to except from the purview of §26 the real estate held by the land banks.

* * *

Nothing in the legislative history of §26 commands a contrary result; and a broad construction is indicated by Congress's intention to advance credit to farm borrowers at the lowest possible interest rate. The legislative history of similar exemption clauses in other statutes supports our interpretation of §26 [citations and footnotes omitted].

Similarly, in the landmark case of *Laurens Federal Savings and Loan Association v. South Carolina Tax Commission, 365 U.S. 517 (1961), the Supreme Court broadly construed the exemption from State taxation granted by* §13. In that case, the State of South Carolina attempted to impose a documentary stamp tax upon promissory notes executed by the association evidencing loans it had received from the Federal Home Loan Bank of Greensboro (now Atlanta). The Supreme Court of South Carolina affirmed the State's taxing power on the ground that although §13 completely exempted such loans from State taxation, it did not "cover the stamp tax on the promissory notes securing the loans because these taxes were imposed upon the borrowing Association rather than upon the lending . . . Bank" and, therefore, such tax was not a tax on the Bank's loans within the meaning of §13. In rejecting this contention and declaring the tax invalid, the United States Supreme Court held that the issue had been resolved by its decision in *Pittman v. Home Owners' Loan Corporation,* 308 U.S. 21 (1939), a case in which the Court declared a Maryland stamp tax upon mortgages executed in favor of the HOLC to be a tax upon its loans which were exempted from taxation by §4(c) of the Home Owners' Loan Act of 1933. As the Supreme Court viewed the issue in *Laurens,* the South Carolina tax constituted a pro-

hibited tax on Bank advances, and it was of "no determining significance" that the tax was paid by the borrowing association rather than the lending Bank. The Court stated (365 U.S. at 519-521):

> The first question is whether the immunity granted "advances" of the Federal Home Loan Bank by the 1932 Act is broad enough to bar state stamp taxes on this loan transaction. We decided a very similar question in *Pittman v. Home Owners' Loan Corp.*, 308 U.S. 21. . . .
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> * * *
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> The state court in the present case, although drawing no disctinction between the terms "loans" and "advances," nevertheless thought the *Pittman* decision inapplicable here because in that case the mortgage was presented for recording by the exempt lender itself (the Home Owners' Loan Corporation) while here the South Carolina tax was assessed against the borrowing petitioner association rather than against the exempt lender (the Home Loan Bank). We distinctly said in *Pittman*, however, that the fact that the state taxing statute did not require payment of the tax by the lender has "no determining significance," our reason being that "'whoever pays it it is a tax upon the mortgage and that is what is forbidden by the law of the United States.'" We went on in *Pittman* to recognize that the real question was whether the "critical term . . . *'loans'* . . . should be construed as covering the entire process of lending, the debts which result therefrom and the mortgages given . . . as security." The question here is the same as to the synonymous term "advances" and as to the promissory notes securing the advances, since the language of the exemption is equally broad. . . . [footnotes omitted].

While the Court was of the opinion that the exemption provisions of §13 were sufficiently broad to bar the tax in question, as indicated above, it noted further that the tax contravened the

basic Congressional purpose in "insulating" Bank advances from State taxation (365 U.S. at 521, 522):

> While the question of the breadth of the exemption of "advances" in the 1932 Act thus is persuasively answered by our reasoning in *Pittman*, the same conclusion is called for by the language and legislative history of that Act as a whole. It set up a system of federally chartered Home Loan Banks for the purpose, as stated in the House and Senate Committee Reports, of placing "long-term funds in the hands of local institutions" in order to alleviate the pressing need of home owners for "low-cost, long-term, installment mortgage money" and to "decrease costs of mortgage money" with a "resulting benefit to home ownership in the form of lower costs and more liberal loans." It is to this end that the Act authorizes the Federal Home Loan Banks to make "advances" of funds to eligible borrower institutions "upon the note or obligation" of the borrower secured primarily by mortgages on homes. The exemption of these "advances" from taxation obviously is in keeping with the Act's overall policy of making these mortgage funds available at low cost to home owners. Regardless of who pays the documentary stamp taxes here at issue, the necessary effect of the taxes is to increase the cost of obtaining the advances of funds from the Home Loan Bank to be used in making loans to home owners. In this impact, therefore, this tax, whether nominally imposed on the Bank or on the petitioner, is bound to increase the cost of loans to home owners and thus contravene the basic purpose of Congress in insulating these advances from state taxation. . . . [footnotes omitted].

In our opinion, the Supreme Court's view of the State tax sought to be imposed in *Laurens* is equally applicable to the attempt by the State of Arkansas to tax dividends on Federal Home Loan Bank stock held by member associations located in that State. Ownership of such stock is not voluntary but, on the

contrary, is a condition of membership the the Federal Home Loan Bank System. By statutory definition (§2(4) of the Bank Act), a Federal Home Loan Bank member is an "institution which has subscribed" for Bank stock. Section 6(c) of the Act provides a formula for the amount of stock each member must own and maintain as long as it retains Bank membership. This amount, in turn, is directly related to the member's advances (§6(c)(2)(ii)) and, under §10(c) of the Act, each Bank has a statutory lien on the stock issued to borrowing members as security for its advances. The stock is, therefore, an integral part of the entire advance mechanism of the Banks.

Moreover, payment of dividends on the outstanding capital stock of a Federal Home Loan Bank represents, in essence, a distribution of the income of the Bank (§16 of the Bank Act). And in the words of the Supreme Court in the *Laurens* case, it is of "no determining significance" whether the tax on such income is paid by the Bank or by a member savings and loan association. Further, to paraphrase the language used by the Court, "whoever pays it it is a tax upon the [income of a Federal Home Loan Bank] and that is what is forbidden by the law of the United States". 365 U.S. at 520. Therefore, consistent with the rationale of the *Laurens* opinion and the Congressional intent manifested in §7 and its legislative history (there being no legislative history of §13 should, in our view, be broadly construed to include dividends paid to member associations on their holdings of capital stock issued by the Federal Home Loan Banks.

Additional evidence of the Congressional intent to exempt such dividends from State taxation is provided by reference to 31 U.S.C. 742(a) (as amended by §6 of the Public Debt Act of

1942, effective as of March 28, 1942).[3] Among other things, §742(a) removes the Federal (but not the State) tax exemption from "dividends, earnings, or other income from shares, certificates, stock, or other evidences of ownership" issued on or after March 28, 1942, "by the United States or any agency or instrumentality thereof". That the term "instrumentality" of the United States as used in this section applies to Federal Home Loan Banks, is not open to question (*Fahey v. O'Melveny & Meyers, supra,* 200 F.2d at 446-447), and the language of §742(a) manifests the clear Congressional understanding that the §13 tax exemption includes dividends paid on the capital stock issued by the Banks.[4] The Internal Revenue Service—the

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[3] As amended on March 28, 1942, said section 742(a) read in part as follows:

> "(a) *Interest upon* obligations, and *dividends, earnings, or other income from shares, certificates, stock, or other evidences of ownership,* and gain from the sale or other disposition of such obligations a. [4] evidences of ownership *issued on or after the effective date of the Public Debt Act of 1942 by the United States or any agency or instrumentality thereof shall not have any exemption, as such,* and loss from the sale or other disposition of such obligations or evidences of ownership shall not have any special treatment, as such, *under Federal Tax Acts now or hereafter enacted. . . .* " [Emphasis added]

A 1947 Amendment to §742(a) substituted the phrase "under the Internal Revenue Code . . . " for "Federal Tax Acts now or hereafter enacted"; and in 1959, this language was changed to its present style to specify the "Internal Revenue Code of 1954". See the notes to 12 U.S.C.A. 742(a). However, neither amendment referred to or removed the State tax exemption.

[4] In this regard, Senate Report No. 1173, 77th Cong., 2d Sess., explains that (p.3):

> The Public Debt Act of 1941 removed the tax-exemption privilege from obligations issued by the United States and agencies and instrumentalities of the United States after the effective date of that act but the tax-exemption privilege enjoyed by shares and other evidences of ownership issued by the various agencies and instrumentalities of the United States was overlooked. The bill [H.R. 6691 which was enacted as the Public Debt Act of 1942] would remove the tax-exemption

Federal agency most directly concerned—also takes this position with respect to the Federal taxation of such dividends pre- or post 1942, as evidenced by the IRS regulations implementing 31 U.S.C. 742(a) (26 CFR 1.103-2). See, also, the related excerpts published by the Commerce Clearing House, a nationally recognized Federal tax reporter (751 CCH—Standard Federal Tax Reports, pp. 14, 128-14,130), copies of which are enclosed for your information.

For the foregoing reasons it is, therefore, our opinion that dividends on Federal Home Loan Bank stock paid to member associations located in the State of Arkansas are not includable in their gross income for State tax purposes.

Sincerely,

S/S Charles E. Allen

Charles E. Allen
General Counsel

Enclosures

Footnote 4 continued:

privilege on the shares of stock and other evidences of ownership hereafter issued by such agencies and instrumentalities. Some of the organizations the shares of which would be affected by this change are the Federal savings and loan associations, the Federal Reserve banks, the national mortgage associations, the Federal land banks, the national farm loan associations, and the Federal intermediate credit banks. This provision would not in any way affect the status for tax purposes of any agency or instrumentality of the United States.

APPENDIX G

Title 68 Oklahoma Statutes §2353:

10. "Taxable income" with respect to any taxpayer means the "taxable income," "life insurance company taxable income," "mutual insurance company taxable income," "regulated investment company taxable income," "real estate investment trust taxable income," and "cooperatives' taxable income" and any other "taxable income" as defined in the Internal Revenue Code as applies to such taxpayer or any income of such taxpayer; provided, in the case of income derived from oil and gas well production, any taxpayer, at his option, may deduct as an allowance for depletion, in lieu of other calculation of depletion based on the cost of the oil and gas deposit, twenty-two percent (22%) of the gross income derived from the properties during the taxable year, but such allowance shall not exceed fifty percent (50%) of the net income of the taxpayer (computed without allowance for depletion) from the property; if a depletion allowance is allowed as a deduction in arriving at the adjusted gross income in the case of an individual, or taxable income for corporations and trusts or distributable income of partnerships by the Internal Revenue Service, the percentage depletion so calculated shall in no event be a duplication of depletion allowed on the Federal Income Tax Return;

11. "Adjusted gross income" means "adjusted gross income" as defined in the Internal Revenue Code;

12. "Oklahoma taxable income" means "taxable income" as reported (or as would have been reported by the taxpayer had a return been filed) to the federal government, and in the event of adjustments thereto by the federal government as finally ascertained under the Internal Revenue Code, adjusted further as hereinafter provided;

13. "Oklahoma adjusted gross income" means "adjusted gross income" as reported to the federal government (or as would have been reported by the taxpayer had a return been filed), or in the event of adjustments thereby by the federal government as finally ascertained under the Internal Revenue Code, adjusted further as hereinafter provided; . . .

APPENDIX H

12 USC §1433. Exemption from taxation; obligations acceptable as credit on debt of home owner

Any and all notes, debentures, bonds, and other such obligations issued by any bank, and consolidated Federal Home Loan Bank bonds and debentures, shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority. The bank, including its franchise, its capital, reserves, and surplus, its advances, and its income shall be exempt from all taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority; except that [in] any real property of the bank shall be subject to State, Territorial, county, municipal, or local taxation to the same extent according to its value as other real property is taxed. The notes, debentures, and bonds issued at any bank, with unearned coupons attached, shall be accepted at par by such bank in payment of or as a credit against the obligation of any home-owner debtor of such bank.

APPENDIX I

31 USC §742. Exemption from taxation

All stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.

31 USC §742a. Application of other laws

(a) Exemption from taxation under Internal Revenue Code; exceptions. Interest upon obligations, and dividends, earnings, or other income from shares, certificates, stock, or other evidences of ownership, and gain from the sale or other disposition of such obligations and evidences of ownership issued on or after the effective date of the Public Debt Act of 1942 [enacted Mar. 28, 1942] by the United States or any agency or instrumentality thereof shall not have any exemption, as such, and loss from the sale or other disposition of such obligations or evidences of ownership shall not have any special treatment, as such, except as provided under the Internal Revenue Code of 1954 [26 USCS §§1 et seq.]; except that any such obligations which the United States Maritime Commission or the Federal Housing Administration had, prior to March 1, 1941, contracted to issue at a future date, shall when issued bear such tax-exemption privileges as were, at the time of such contract, provided in the law authorizing their issuance. For the purposes of this subsection a Territory, a possession of the United States, and the District of Columbia, and any political subdivision thereof, and any agency or instrumentality of any one or more of the forego-

ing, shall not be considered as an agency or instrumentality of the United States.

(b) Provisions of this section as amendatory and supplementary to other provisions. The provisions of this section shall, with respect to such obligations and evidences of ownership, be considered as amendatory of and supplementary to the respective Acts or parts of Acts authorizing the issuance of such obligations an evidences of ownership, as amended and supplemented.

(c) Amendment or repeal of provisions of the Revenue Act of 1941. Nothing contained herein shall be construed to amend or repeal sections 114 and 115 of the Revenue Act of 1941.

APPENDIX J

Title 68 Oklahoma Statutes §2358A.2.

2. There shall be deducted amounts included in such income that the state is prohibited from taxing because of the provisions of the Federal Constitution, the State Constitution, federal laws or laws of Oklahoma.

APPENDIX K

12 USC 1464(h)

(h) Exemptions from taxation. No state, county, municipal, or local taxing authority shall impose any tax on such associations or their franchise, capital, reserves, surplus, loans, or income greater than that imposed by such authority on other similar local mutual or cooperative thrift and home financing institutions.